

BANK INDONESIA REGULATION
NUMBER: 6/10/PBI/2004
CONCERNING
RATING SYSTEM FOR COMMERCIAL BANKS

THE GOVERNOR OF BANK INDONESIA,

- Considering :
- a. whereas the soundness of a bank is of interest to all stakeholders, including owners, management of the bank, the public using the services of the bank, and Bank Indonesia as the bank supervisory authority;
 - b. whereas the rapid pace of advancements in banking has brought about the increased complexity of bank business and risk profiles of banks;
 - c. whereas changes in the business complexity and risk profiles of banks and changes in internationally applied methodology for rating of bank condition will affect the existing system for Bank Rating;
 - d. now therefore it is deemed necessary to enact new provisions concerning the Rating System for Commercial Banks in a Bank Indonesia Regulation;

- In view of :
- 1. Act Number 7 of 1992 concerning Banking (State Gazette of the Republic of Indonesia Number 31 of 1992, Supplement to the State Gazette Number 3472) as amended by Act Number 10 of 1998 (State Gazette of the Republic

of Indonesia Number 182 of 1998, Supplement to the State Gazette Number 3790);

2. Act Number 23 of 1999 concerning Bank Indonesia (State Gazette of the Republic of Indonesia Number 66 of 1999, Supplement to the State Gazette Number 3843) as amended by Act Number 3 of 2004 (State Gazette of the Republic of Indonesia Number 7 of 2004, Supplement to the State Gazette Number 4357);

HAS DECREED:

To enact: THE BANK INDONESIA REGULATION CONCERNING
RATING SYSTEM FOR COMMERCIAL BANKS.

CHAPTER I
GENERAL PROVISIONS

Article 1

The terminology used in the Bank Indonesia Regulation has the following meanings:

1. Bank is a Commercial Bank conducting conventional business as defined in Act Number 7 of 1992 concerning Banking as amended by Act Number 10 of 1998, including a branch office of a foreign bank.
2. Board of Directors:
 - a. for a Bank legally incorporated as a Limited Liability Company is a board of directors as referred to in Article 1 number 4 of Act Number 1 of 1995 concerning Limited Liability Companies;

- b. for a Bank legally incorporated as a Regional Government Enterprise is a board of directors as referred to in Article 11 of Act Number 5 of 1962 concerning Regional Government Enterprises;
 - c. for a Bank legally incorporated as a Cooperative is an executive board as referred to in Article 29 of Act Number 25 of 1992 concerning Cooperatives;
- 3. Board of Commissioners:
 - a. for a Bank legally incorporated as a Limited Liability Company is a board of commissioners as referred to in Article 1 number 5 of Act Number 1 of 1995 concerning Limited Liability Companies;
 - b. for a Bank legally incorporated as a Regional Government Enterprise is a board of supervisors as referred to in Article 19 of Act Number 5 of 1962 concerning Regional Government Enterprises;
 - c. for a Bank legally incorporated as a Cooperative is a board of supervisors as referred to in Article 38 of Act Number 25 of 1992 concerning Cooperatives.
- 4. Bank Rating is the qualitative rating of various aspects affecting the condition or performance of a Bank by means of Quantitative Rating and/or Qualitative Rating of the factors of capital, asset quality, management, earnings, liquidity, and sensitivity to market risk.
- 5. Composite Rating is the ultimate rating obtained in the Bank Rating process.
- 6. Quantitative Rating is rating of the position, developments, and projection of the financial ratios of the Bank.
- 7. Qualitative Rating is rating of the factors supporting the results of Quantitative Rating, application of risk management, and the compliance of the Bank.

Article 2

- (1) Banks are required to conduct business on the basis of prudential principles with the objective of maintaining or improving Bank Rating.
- (2) The Board of Commissioners and Board of Directors of a Bank are required to monitor and take the necessary measures for achievement of Bank Rating as referred to in paragraph (1).

Article 3

The scope of Bank Rating encompasses rating of the following factors:

- a. capital;
- b. asset quality;
- c. management;
- d. earnings;
- e. liquidity; and
- f. sensitivity to market risk.

Article 4

- (1) Rating of the capital factor as referred to Article 3 letter a encompasses rating of the following components:
 - a. adequacy, composition, and projection (forward trend) in capital and the capacity of Bank capital to cover problem assets;
 - b. capacity of the Bank to meet the need for additional capital from earnings, capital plan of the Bank to support business expansion, access to sources of capital, and financial performance of shareholders in building the capital of the Bank.

(2) Rating ...

- (2) Rating of the asset quality factor as referred to Article 3 letter b encompasses rating of the following components:
- a. earning assets quality, concentration of credit risk exposure, developments in problem earning assets, and adequacy of allowance for earning asset losses;
 - b. adequacy of policy and procedures, internal review system, documentation system, and performance in management of problem earning assets.
- (3) Rating of the management factor as referred to Article 3 letter c encompasses rating of the following components:
- a. quality of general management and application of risk management;
 - b. Bank compliance with applicable legal provisions and commitments made to Bank Indonesia and/or other parties.
- (4) Rating of the earnings factor as referred to Article 3 letter d encompasses rating of the following components:
- a. performance in return on assets (ROA), return on equity (ROE), net interest margin (NIM), and level of efficiency of the Bank.
 - b. developments in operating profit, diversification of revenues, application of accounting principles in recognition of revenues and expenses, and prospects for operating profit.
- (5) Rating of the liquidity factor as referred to Article 3 letter e encompasses rating of the following components:
- a. ratio of liquid assets/liabilities, potential for maturity mismatch, condition of Loan to Deposit Ratio (LDR), cash flow projection, and funding concentrations;
 - b. adequacy of policy and management of liquidity (assets and liabilities management/ALMA), access to funding sources, and stability of funding.

- (6) Rating of the factor of sensitivity to market risk as referred to Article 3 letter f encompass rating of the following components:
- a. capacity of Bank capital for covering potential loss from adverse movement in interest rates and exchange rates;
 - b. adequacy of application of market risk management.

Article 5

The rating of each component referred to in Article 4 shall be determined by means of calculation and analysis, taking account of supporting indicators and/or relevant benchmarks.

Article 6

- (1) Based on the rating of each component referred to in Article 5, a rating shall be determined for each factor.
- (2) The process for determining the rating of each factor as referred to in paragraph (1) shall take place after taking account of judgement based on the materiality and significance of each rated component.

Article 7

- (1) The Composite Rating shall be determined on the basis of the rating of each of the factors referred to in Article 6.
- (2) Composite Rating as referred to in paragraph (1) shall be determined as follows:

a. Composite ...

- a. Composite Rating 1 (PK-1), indicating that the Bank is in excellent condition and able to withstand impact from negative changes in economic conditions and the financial industry;
 - b. Composite Rating 2 (PK-2), indicating that the Bank is in sound condition and is able to withstand impact from negative changes in economic conditions and the financial industry, notwithstanding the Bank still has minor weaknesses that can be quickly resolved through routine measures;
 - c. Composite Rating 3 (PK-3), indicating that the Bank is in fairly sound condition but has weaknesses that may lead to deterioration in composite rating if the Bank does not take immediate corrective actions;
 - d. Composite Rating 4 (PK-4), indicating that the Bank is in poor condition and sensitive to impact from negative changes in economic conditions and the financial industry, or that the Bank has serious financial weaknesses or a combination of a number of unsatisfactory factors that if not addressed with effective corrective actions could potentially lead to difficulties endangering its survival.
 - e. Composite Rating 5 (PK-5), indicating that the Bank is in unsound condition and highly sensitive to impact from negative changes in economic conditions and the financial industry, and is experiencing financial difficulties endangering its survival.
- (3) The process for determining Composite Rating as referred to in paragraph (2) shall take place after taking account of judgement based on the materiality and significance of each rated factor.

CHAPTER II

RATING MECHANISM AND CORRECTIVE ACTIONS

Article 8

- (1) Banks are required to conduct Bank Rating in accordance with this Bank Indonesia Regulation on a quarterly basis for the positions of March, June, September, and December.
- (2) If necessary, Bank Indonesia shall request the result of the Bank Rating conducted by the Bank as referred to in paragraph (1).

Article 9

- (1) For the purpose of Bank supervision, Bank Indonesia shall conduct Bank Rating each quarter.
- (2) Bank Rating shall be conducted on the basis of examination, the periodic reports submitted by the Bank, and/or other information in the public domain, such as assessment by another competent authority or competent agency.
- (3) In the event of any differences in the result of Bank Rating conducted by Bank Indonesia and the result of Bank Rating conducted by the Bank, the result of the Bank Rating conducted by Bank Indonesia shall prevail.
- (4) On the basis of rating as referred to in paragraph (1), Bank Indonesia may request the Board of Directors, Board of Commissioners, and/or shareholders to submit an action plan stating the corrective actions that must be implemented by the Bank in regard to any significant problems, including timeframes for resolution over specific period.
- (5) If necessary, Bank Indonesia shall request the Bank to make adjustments to an action plan as referred to in paragraph (4).

Article 10

- (1) Banks are required to submit an action plan implementation report as referred to in Article 9 paragraph (4) no later than 10 (ten) working days after implementation of the action plan.
- (2) If the case of phased implementation of an action plan, the Bank shall be required to report the phases of implementation of the action plan no later 10 (ten) working days after completion of each phase of the action plan.

Article 11

If necessary, Bank Indonesia shall conduct special examination of the corrective actions undertaken by the Bank.

CHAPTER III

RATING FOR BRANCH OFFICES OF FOREIGN BANKS

Article 12

In the case of a branch office of a foreign bank, Bank Rating shall be conducted only for the asset quality factor as referred to in Article 3 letter (b) and the management factor as referred to in Article 3 letter (c).

Article 13

The Composite Rating shall be determined on the basis of the rating of each of the factors referred to in Article 12, as follows:

- a. Composite Rating 1 (PK-1), indicating that the branch office of the foreign bank has very good asset quality, has and applies effective and comprehensive risk management and operational controls, and has

maintained ...

maintained consistent compliance with the applicable legal provisions and internal procedures;

- b. Composite Rating 2 (PK-2), indicating that the branch office of the foreign bank has good asset quality, has instituted and applied adequate risk management and operational controls, and has maintained consistent compliance with the applicable legal provisions and internal procedures, notwithstanding a few weaknesses that may be immediately remedied through corrective actions;
- c. Composite Rating 3 (PK-3), indicating that the branch office of the foreign bank has fairly good asset quality, has instituted and applied fairly adequate risk management and operational controls, complies with the applicable legal provisions and internal procedures albeit not fully consistently, and has weaknesses that may lead to deterioration in composite rating if the Bank does not take immediate corrective actions;
- d. Composite Rating 4 (PK-4), indicating that the branch office of the foreign bank has deteriorating asset quality, has instituted and applied weak risk management and operational controls lacking in consistent application, and has significant frequency of infringements of the applicable legal provisions and internal procedures;
- e. Composite Rating 5 (PK-5), indicating that the branch office of the foreign bank has undergone steady deterioration in asset quality, has extremely weak and inconsistently applied risk management and operational controls, and has significant frequency of infringements of the applicable legal provisions and internal procedures.

Article 14

If necessary, Bank Indonesia may request a branch office of a foreign bank to provide up to date data or information on the rating of the foreign bank head office on a regular basis or at any time.

CHAPTER IV

SANCTIONS

Article 15

Any Bank violating the provisions stipulated in Article 2, Article 8 paragraph (1), Article 10, and Article 16 paragraph (2) shall be liable to administrative sanctions as referred to in Article 52 of Act Number 7 of 1992 concerning Banking as amended by Act Number 10 of 1998, comprising the following:

- a. written warning;
- b. freezing of specific business lines;
- c. inclusion of the management and/or shareholders of the Bank in the list of persons prohibited from becoming shareholders and managers of Banks.

CHAPTER V

TRANSITIONAL PROVISIONS

Article 16

- (1) Operation of the Bank Rating system as referred to in this Bank Indonesia Regulation shall become effective commencing from the position for December 2004.
- (2) To prepare for effective application of the Bank Rating system as referred to in paragraph (1), Banks shall be required to conduct pilot testing of Bank

Rating as referred to in Article 8 commencing from the position for June 2004.

- (3) If necessary, Bank Indonesia shall request the results of the Rating conducted by a Bank as referred to in paragraph (2).
- (4) Prior to the effective application of the Bank Rating system as referred to in this Bank Indonesia Regulation, Bank Rating shall be conducted by Bank Indonesia pursuant to Decree of the Management of Bank Indonesia Number 30/11/KEP/DIR dated April 30, 1997, concerning Rating Procedure for Commercial Banks as amended by Decree of the Management of Bank Indonesia Number 30/277/KEP/DIR dated March 19, 1998.

CHAPTER VI CONCLUDING PROVISIONS

Article 17

Further provisions necessary for the implementation of this Bank Indonesia Regulation shall be stipulated in a Circular Letter of Bank Indonesia.

Article 18

With the enactment of this Bank Indonesia Regulation:

- a. Decree of the Management of Bank Indonesia Number 30/11/KEP/DIR dated April 30, 1997, concerning Rating Procedure for Commercial Banks and Decree of the Management of Bank Indonesia Number 30/277/KEP/DIR dated March 19, 1997, concerning Amendment to Decree of the Management of Bank Indonesia Number 30/11/KEP/DIR dated April 30, 1997, concerning Rating Procedure for Commercial Banks are declared no longer valid for

Commercial Banks conducting conventional business commencing from Bank Rating for the position at end of December 2004;

- b. Decree of the Management of Bank Indonesia Number 30/266/KEP/DIR dated February 27, 1998, concerning Implementation of Prudential Principles Concerning Interbank Liabilities, Negotiation of Claims, Deposit Interest Rates, and Provision of Funds is revoked and declared no longer valid.

Article 19

This Bank Indonesia Regulation shall come into force on the date of its enactment.

Enacted in: Jakarta

Dated: April 12, 2004

THE GOVERNOR OF BANK INDONESIA,

BURHANUDDIN ABDULLAH

STATE GAZETTE OF THE REPUBLIC OF INDONESIA NUMBER 38 OF
2004

DPNP

ELUCIDATION
TO
BANK INDONESIA REGULATION
NUMBER 6/10/PBI/2004
CONCERNING
RATING SYSTEM FOR COMMERCIAL BANKS

GENERAL REVIEW

The soundness or financial and non-financial condition of a Bank is of interest to all stakeholders, including owners, management of the Bank, the public using the services of the Bank, Bank Indonesia as the Bank supervisory authority, and other parties. This information on the condition of the Bank can be used by these stakeholders to evaluate the performance of the Bank in application of prudential principles, regulatory compliance, and risk management.

Advancements in the banking industry and particularly the mounting complexity and variety of products and services will heighten the risk exposures faced by Banks. Changes in risk exposures and application of risk management will influence the risk profile of a Bank, which in turn will affect the overall condition of the Bank.

The methodology for rating the condition of Banks is in a never-ending process of dynamic change, and thus new legal provisions must be established for the Bank rating system to better reflect the present and future condition of Banks. These new legal provisions include but are not limited to improvements in rating approach (qualitative and quantitative) and addition of new rating factors.

For banks, the outcome of rating of Bank condition can be used as a means to determine future business strategy, while for Bank Indonesia, it is used among others as a means for determining and implementing the strategy for Bank supervision.

For Banks to be able to apply the Bank rating system set forth in this Bank Indonesia Regulation within the stipulated timeframe, it is necessary for banks to prepare themselves for application of the system.

ARTICLE BY ARTICLE

Article 1

Self-explanatory

Article 2

Paragraph (1)

Self-explanatory

Paragraph (2)

Self-explanatory

Article 3

Letter a

Rating of capital is rating of the adequacy of Bank capital for covering current risk exposures and anticipating future risk exposures.

Letter b

Rating of asset quality is the rating of the condition of Bank assets and adequacy of credit risk management.

Letter c ...

Letter c

Rating of management is the rating of the managerial capacity of the Bank management in conducting its business, adequacy of risk management, and compliance of the Bank with applicable legal provisions and commitments made to Bank Indonesia and/or other parties.

Bank compliance is defined as the compliance of the Bank with applicable legal provisions, including but not limited to the Legal Lending Limit, Net Open Position, and Know Your Customer Principles.

Letter d

Rating of earnings is the rating of the condition and capacity of Bank earnings to sustain operations and capital.

Letter e

Rating of liquidity is the rating of the capacity of the Bank to maintain adequate levels of liquidity and adequacy of liquidity risk management.

Letter f

Rating of sensitivity to market risk is rating of the adequacy of Bank capital for covering consequences arising from changes in market risks and adequacy of market risk management.

Article 4

Paragraph (1)

Self-explanatory

Paragraph (2)

Self-explanatory

Paragraph (3) ...

Paragraph (3)

Self-explanatory

Paragraph (4)

Self-explanatory

Paragraph (5)

Self-explanatory

Paragraph (6)

Self-explanatory

Article 5

The rating scale for each component consists of rating 1, rating 2, rating 3, rating 4, and rating 5.

A lower number on the rating scale indicates a higher level for the condition of the Bank.

Article 6

Paragraph (1)

The rating scale for each factor consists of rating 1, rating 2, rating 3, rating 4, and rating 5.

A lower number on the rating scale indicates a higher level for the condition of the Bank.

Paragraph (2)

Judgement is a conclusion reached objectively and independently on the basis of analysis supported by adequate and properly documented facts, data, and information to obtain a rating that reflects the true and actual condition of the Bank.

Article 7

Paragraph (1)

Self-explanatory

Paragraph (2)

A lower number on the Composite Rating scale indicates a higher level for the condition of the Bank.

Letter a

This rating means that the Bank is able to maintain control over business in the event of any significant change in the banking industry.

Letter b

Minor weaknesses in this letter may comprise administrative and operational weaknesses that do not significantly influence the condition of the Bank.

Letter c

Self-explanatory

Letter d

Self-explanatory

Letter e

Self-explanatory

Paragraph (3)

Judgement is a conclusion reached objectively and independently on the basis of analysis supported by adequate and properly documented facts, data, and information to obtain a rating that reflects the true and actual condition of the Bank.

Article 8

Paragraph (1)

Self-explanatory

Paragraph (2)

Self-explanatory

Article 9

Paragraph (1)

In order to obtain a Rating result commensurate to the actual condition of the Bank, Bank Indonesia may request the Bank to provide information and clarification.

Bank Indonesia may adjust any Bank Rating if it becomes informed of data and information on any subsequent events that significantly affect the condition of the Bank.

Paragraph (2)

Self-explanatory

Paragraph (3)

Self-explanatory

Paragraph (4)

Bank Indonesia may request the Board of Directors, Board of Commissioners, and/or shareholders to submit an action plan if the result of the Bank Rating shows that one or more of the rating factors are rated 4 and/or rated 5.

Paragraph (5)

Any action plan that is submitted shall be treated as a commitment of the Bank toward Bank Indonesia.

Article 10

Paragraph (1)

The action plan implementation report submitted by the Bank shall include but not be limited to evidence of implementation and relevant supporting documents.

Paragraph (2)

Self-explanatory

Article 11

Self-explanatory

Article 12

Components in the asset quality factor are as set forth in Article 4 paragraph (2), while the components in the factor of management are as set forth in Article 4 paragraph (3).

Article 13

The process of determining the Composite Rating shall be preceded by rating of each component as referred to in Article 5 and rating of each factor as referred to in Article 6.

Article 14

Rating of a foreign bank head office shall be conducted by an international rating agency, including but not limited to Standard & Poor's, Moody's, and Fitch.

Article 15

Self-explanatory

Article 16 ...

Article 16

Paragraph (1)

Self-explanatory

Paragraph (2)

Self-explanatory

Paragraph (3)

Self-explanatory

Paragraph (4)

Self-explanatory

Article 17

Self-explanatory

Article 18

Self-explanatory

Article 19

Self-explanatory